Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Access Charge Reform	)	**CC Docket No. 96-262**
In the Matter of Price Cap Performance Review for Local Exchange Carriers	)	**CC Docket No. 94-1**
In the Matter of Consumer Federation of America, International Communications Assoc., and National Retail Federation Petition Requesting Amendment the Commission's Rules Regarding Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers	)	**RM-9210**

COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY

Cincinnati Bell Telephone Company ("CBT"), an independent, mid-size local exchange carrier, files these comments in response to the Commission's October 5, 1998 Public Notice in the above-referenced proceedings. In these comments, CBT updates and refreshes the record regarding the appropriate level of the X-factor for mid-size LECs and the need for uniform guidelines for pricing flexibility concurrent with the development of competition. CBT also provides evidence that a prescriptive approach to access reform is unnecessary.

A. A LOWER X-FACTOR IS WARRANTED FOR MID-SIZE LECS

As the Commission continues its review of the X-factor, CBT stresses once again the importance of establishing a separate X-factor for elective price cap companies (i.e., 2% mid-size companies). On July 11, 1997, CBT filed a Petition for Reconsideration

("PFR") of the Commission's Fourth Report and Order in CC Docket No. 94-1 challenging the validity of the 6.5% X-factor for elective price cap LECs.[1] Citizens Utilities also filed a PFR regarding the inappropriateness of the 6.5% X-factor.[2] As these PFRs substantiate, the Commission in the Fourth Report and Order failed to recognize the heterogeneity of the elective price cap LECs that warranted a different X-factor for these carriers.

With its PFR, CBT submitted a paper by Jeffrey H. Rohlfs and Kirsten M. Pehrsson examining why a single X-factor for all LECs is inappropriate and demonstrating that the difference between CBT and the RBOC productivity growth is substantial.[3] Using the Commission's TFP methodology, the analysis shows that the difference between CBT's and the RBOC's productivity growth over selected time periods was enormous. The differential for the 1990 to 1995 period was 3.1 percent per year while the differential was 1.5 percent per year for the 1991 to 1995 period. On May 14, 1998, the Independent Telephone and Telecommunications Alliance ("ITTA") refreshed the record in CC Docket No. 94-1 by submitting another paper by Dr. Rohlfs and Ms. Pehrsson that supplements the earlier paper by including data from Aliant, another mid-size company. The findings of this paper continue to support the earlier conclusions that the 6.5% X-Factor is inappropriate for 2% mid-size LECs and that a significant difference exists between the productivity growth rates for the RBOCs and 2% mid-size LECs.

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[1] CBT Petition for Reconsideration filed July 11, 1997 *In the Matter of Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, *Fourth Report and Order,* hereinafter referred to as CBT's PFR.

[2] Petition for Reconsideration of Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262 filed by Citizens Utilities Company July 11, 1997.

[3] "One Size Does Not Fit All: The Inadequacy of a Single X-Factor for All Price-Cap Companies" Jeffrey H. Rohlfs and Kirsten M. Pehrsson. Submitted on July 11, 1997 as an attachment to CBT's PFR.

CBT finds it difficult to understand why the Commission would continue to ignore the differences between 2% mid-size LECs and large LECs in this proceeding while recognizing them in other proceedings. On several occasions since the release of the Fourth Report and Order the Commission has recognized that there are differences between large and mid-size LECs that warrant different regulatory treatment. In its 1998 Biennial Review, the Commission has tentatively concluded that the accounting, ARMIS and cost allocation requirements for mid-size LECs should be streamlined and simplified. It has also proposed eliminating the requirement that mid-size LECs file annual theoretical reserve studies as part of the depreciation prescription process.[4] The Commission observes in the Depreciation NPRM that since the large LECs represent over 90 percent of the industry, relieving the mid-size companies of filing the annual theoretical reserve study will not encumber the Commission's ability to monitor the depreciation prescription process.[5] This reinforces CBT's position in its PFR[6] that the mid-size LECs comprise such a small portion of the total that even if combined with the large LECs their data will not affect the total result.

CBT submits that the Commission's prior recognition of the existence of the heterogeneity of the elective price cap LECs,[7] the recent recognition of differences

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[4] See, *1998 Biennial Regulatory Review – Review of ARMIS Reporting Requirements*, CC Docket No. 98-117, *Notice of Proposed Rulemaking*, FCC 98-152 (July 17, 1998) ("ARMIS NPRM"); *1998 Biennial Regulatory Review – Review of Accounting and Cost Allocation Requirements, United States Telephone Association Petition for Rulemaking*, CC Docket No. 98-81, *Notice of Proposed Rulemaking*, ASD File No. 98-64, FCC 98-108 (June 17, 1998) ("Accounting Reform NPRM"); *1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket No. 98-137, *Notice of Proposed Rulemaking*, , FCC 98-170 (October 14, 1998) ("Depreciation NPRM").
[5] Depreciation NPRM at para. 17.
[6] CBT's PFR at page 6.
[7] See for example, *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313 *Second Report and Order*, at para. 103 "since the foundations of productivity vary from company to company, and since the variations in terms of size, resource base, and geography among independents is so wide, the pitfalls associated with choosing one mandatory productivity number to apply to all such companies are manifest." Also in the *Price Cap Performance Review for Local Exchange Carriers*, CC

between the mid-size LECs and the RBOCs for other regulatory purposes, and the evidence submitted by CBT, Citizens, Aliant and SNET[8] since the release of the Fourth Report and Order all provide sufficient support for the establishment of a separate X-factor for elective price cap LECs.

Although CBT does not have the resources available to conduct a full analysis of LEC industry productivity, CBT submits that the updates and analysis submitted by USTA in its comments in this proceeding are very compelling. As USTA's comments demonstrate, the 6.5% X-factor is too high regardless of whether the Commission's TFP model or the USTA model is used. Moreover, CBT notes that the update of the Commission's TFP model is based on RBOC only data and should not be construed to mean that this result is appropriate for the elective price cap LECs. Rather, the result of the updated Commission TFP model should provide the reference point from which the elective price cap LEC productivity offset factor can be determined by a downward adjustment based on the evidence from the CBT and ITTA studies. Based on the empirical data presented by CBT, ITTA and USTA, the calls for a higher X-factor for all companies are without merit.

B. A MARKET-BASED APPROACH TO ACCESS REFORM SHOULD CONTINUE

CBT submits that the Commission should reject calls by some industry players to prescribe interstate access rates. Less than 18 months ago, the Commission soundly and wisely rejected such a prescriptive approach when it adopted its First Report and Order in

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Docket No. 94-1, *Fourth Further Notice of Proposed Rulemaking*, at para. 109 the Commission acknowledged that "a single X-factor…would not adequately reflect differences in the economic conditions faced by each LEC and thus could unfairly penalize or reward LECs which face conditions that differ from the industry average."

this proceeding.[9] With the phase-in of these reforms not yet complete, and the pricing flexibility component of the reforms not yet determined, the Commission and the industry cannot yet adequately analyze whether the market-based approach is working effectively.

We do not live in a fairytale world where one can wave a magic wand and expect that competition will automatically flourish immediately in every market and that all rates will be cost based. Those who think that the Commission mandating access rates at cost-based rates will magically result in an efficient, competitive marketplace are not being realistic. Mandating cost-based prices would send incorrect signals to competitors seeking to enter the market and may in fact dissuade them from entering. In addition, LECs would be incented to invest in other more profitable areas. The only "benefit" from such a prescriptive approach would be additional reductions for the IXCs with no guarantee that the reductions would be passed on to consumers.[10] Instead, the Commission needs to continue the methodical approach to access reform outlined in the First Report and Order that allows the evolving competitive marketplace to regulate prices. CBT observes that these reforms, coupled with the price cap rules which are designed to replicate a competitive market have been working as intended to reduce access rates. CBT's access rates have been declining for several years and will continue to do so under the present system. CBT's access rates have dropped by more than $40

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[8] See, SNET Petition for Waiver and/or Amendment of Part 61 of the Commission's Rules Establishing an X-Factor of 6.5%, filed August 13, 1997.

[9] *Access Charge Reform*, CC Docket No. 96-262, *First Report and Order*, FCC 97-158, released May 16, 1997.

[10] Based on the manner in which the major IXCs have treated the access reductions that have occurred since January 1, 1998, there is no reason to assume that they will pass through any additional access reductions to consumers. See, Letter from Roy Neel, President and CEO, United States Telephone Association ("USTA") to the Honorable William E. Kennard, October 21, 1998, and accompanying studies by Paul S. Brandon and William E. Taylor of the National Economic Research Associates.

million since July 1, 1993, and more than $18 million since July 1, 1997. In addition, CBT's switched and special access rates continue to be among the lowest in the industry.

The Commission correctly concluded in the First Report and Order that a "…primarily market-based approach to reforming access charges will better serve the public interest than attempting immediately to prescribe new rates for all interstate access services…"[11] A crucial component of this market-based approach is a pricing flexibility plan that transitions services out of price cap regulation as competition develops in particular geographic areas. In spite of the fact that the First Report and Order clearly envisioned a two-phase pricing flexibility plan, the Commission has yet to further develop the plan. It did, however, indicate that it would only resort to a prescriptive approach for areas in which competition does not develop. Thus, while allowing the market-based approach a chance to work, the Commission adopted a prescriptive "backstop" mechanism under which it would assess if the market-based approach was working. Realizing that the transition could not occur overnight, the Commission allowed three years and nine months (i.e., until February 8, 2001) before assessing whether the prescriptive backstop should be triggered.[12]

CBT submits that circumstances have not changed enough in the 18 months since the release of the First Report and Order to warrant moving to a prescriptive approach. Furthermore, because it has not implemented any specific pricing flexibility rules, there is not even a process in place, other than individual forbearance petitions, by which pricing

[11] First Report and Order at para. 263.
[12] "We have chosen this date in order to give competition sufficient time to develop substantially in the various markets for interstate exchange access services. We have also chosen this date to permit us and all interested parties to take into account the effects of implementing the substantial changes that we adopt in this Order and that we will be adopting elsewhere to satisfy the universal service goals in section 254." (*Access Reform First Report and Order* at para. 268)

flexibility can begin to be implemented for individual services and geographic markets. Although forbearance petitions may be useful for addressing unique situations for individual companies or groups of companies, the forbearance process is generally not an efficient means for granting pricing flexibility on a large scale. This is true for several reasons. First, the forbearance process can take over a year and, thus, does not address pricing flexibility requests in a timely fashion. Second, there is no uniformity to the process. There should be some degree of uniformity and certainty so that consistent guidelines are applied to similar competitive circumstances. This will give carriers some idea of the standards by which their applications for pricing flexibility will be judged.

CBT submits that the evidence is incontrovertible that competition is developing both in the local exchange and exchange access markets. For example, CBT currently has 22 signed interconnection agreements, including ten which include unbundled elements. There are currently five facilities-based competitors[13] collocated in four of CBT's high volume central offices. These competitive providers have already captured over 13 percent of the high capacity market (DS1 service and higher) in just over two years. As local exchange service becomes more competitive, CBT will continue to see more significant losses as competitors begin to bundle local switched and high capacity services. In addition, many of CBT's competitors are large national and/or international providers who can offer packages of services to serve all of a customer's telecommunications needs around the world. As this competition continues to put downward pressure on prices, it will become increasingly important for the Commission to give CBT and other LECs the ability to respond to competition through the grant of additional pricing flexibility.

CBT supports the United States Telephone Association ("USTA") pricing flexibility proposal that accompanies the USTA comments in this proceeding. The USTA proposal provides for flexibility based on geographic market conditions by service component. This proposal recognizes that competition is not and will not develop at the same pace in all locations and for all services. The Commission recognized in the First Report and Order that this "is corollary to the rule that firms in competitive markets seek to maximize their profits" and that ultimately this profit-maximizing behavior will lead to increased competition for other customers and services and in other areas.[14] Thus, it is imperative that the pricing flexibility plan enable carriers to qualify for flexibility for services and/or areas for which competition develops. To deny or delay pricing flexibility for more competitive services (or in more competitive areas) because competition has not developed consistently overall will harm consumers in the competitive areas and delay the advent of robust competition in other areas and/or services.

Until the Commission implements pricing flexibility rules, it cannot begin to assess the effectiveness of its market-based approach to access reform. Further complicating any assessment is the fact that the universal service plan is still unresolved. As a result, significant subsidies remain in the access rates. Indeed, CBT submits that with the delay in implementing the universal service reforms, the Commission should consider extending the February 8, 2001 date on which it will review LEC's costs so that any changes implemented as a result of the new universal service plan will have adequate time to take effect.

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[13] Time Warner AxS, MCIMetro, IntelCom Group (ICG), Intermedia Communications (ICI), and TCG.
[14] *Access Charge Reform First Report and Order* at para. 266 and footnote 349.

C. CONCLUSION

In summary, CBT believes that sufficient evidence exists in the record that would allow the Commission to establish a separate lower X-factor for 2% mid-size LECs. CBT also firmly believes that if the Commission truly wants a competitive environment to evolve, it must stay the course of its market-based approach as opposed to establishing a prescriptive approach. In its First Report and Order, the Commission correctly recognized that competition would not take place at the same pace nationwide. That is why it established the prescriptive backstop. If all consumers are to realize the benefits of a competitive telecommunications marketplace, then the Commission must allow LECs some of the same opportunities as their competitors to respond to the signals of the marketplace. Implementing the USTA pricing flexibility proposal will allow this to occur.

Respectfully submitted,

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